UK Social Investment Forum

8 Construction & Building Materials

Potentially material social, ethical & environmental risks

Short term risk | **Long term risk**

Please note that the short and long term risks identified in this section will apply differently to companies within the sector, according to their product range and exposure to various markets. Please see overleaf for key features of the sector and major UK listed companies.

Environmental policy

Short term risk: Government policy is moving towards internalising the cost of environmental impacts. The introduction of the EU Emissions Trading Scheme in 2005 has set a price for excess carbon emissions and is expected to increase electricity prices across the EU, driving up costs for heavy electricity users in this sector. New UK taxes are raising the cost of virgin aggregate materials and waste disposal in landfill. EU regulations to increase energy efficiency in buildings could raise costs for house builders but offer new markets to building materials manufacturers with appropriate products.

Long term risk: Key customers such as the UK Highways Agency, Government Departments and corporate clients are increasingly incorporating sustainable purchasing requirements into the tender process, especially PFI contracts. These often require evidence of an environmental management system and possibly the use of recycled or sustainably sourced materials, as well as the design of energy efficient buildings. Companies failing to respond to customer demand for sustainable products and certified management systems risk losing contracts to their more sustainably-oriented competitors.

Human capital management

Short term risk: Workers in the UK construction industry have a higher than average prevalence rate of work-related ill health. A recent focus on health and safety by leading companies has reduced fatal injuries. However, construction projects also have the potential to cause harm to users and the wider public, e.g. in the rail sector. The use of subcontractors does not necessarily reduce the liability to the main contractor; in fact director liability for injuries and deaths at work can be a significant risk to a board. A poor H&S record can reduce companies' ability to win contracts, particularly for PFI and major infrastructure projects.

Long term risk: There is a shortage of skilled workers in this sector, from labourers to senior management. The industry suffers from a poor image as a career choice; recruitment of talented graduates, especially women, is a significant challenge. The shift towards university rather than apprentice-based training for school leavers, as well as the risk of injury at work, may be contributing to the lack of skilled labour for site work. Greater use of imported labour may relieve short term shortages, but can increase H&S risks (numerous languages and skills levels on one site can contribute to accidents), and does not address long term training and recruitment problems.

Access to future development opportunities

Short term risk: In developed countries, the amenity value placed on undeveloped land has risen to such an extent that gaining permission for new quarrying, industrial plant facilities, commercial or residential development is very difficult. If planning permission is obtained, environmental permitting requirements, social housing targets and regeneration of contaminated urban sites increases the cost of development and may reduce profitability. Companies with good reputations and expertise in operating within a restrictive planning system will have greater success in converting ideas into profitable development opportunities.

Long term risk: The construction of infrastructure projects is often controversial due to their inevitable impact on the physical environment. Local anger at lack of consultation and/or compensation can delay projects and generate negative publicity for the lead contractor. A company able to manage stakeholder relationships effectively to reduce conflict and delays will save costs and endear themselves to clients in controversial sectors. Investment in the local economy can also improve the operating environment for a contractor looking to work long term within a community.

Question: *How is your fund manager incorporating material risks into their company analysis?*

Question: *How is your fund manager engaging with companies on material risks?*

This note forms part of a research programme to identify potentially material social, ethical and environmental risks for each industry sector. Due to the collaborative nature of the work, this analysis does not necessarily reflect the views of each of the fund managers involved.

CIS Co-operative Insurance · Henderson Global Investors · Insight Investment · Jupiter · Morley Fund Management · Schroders · SG Asset Management · USS

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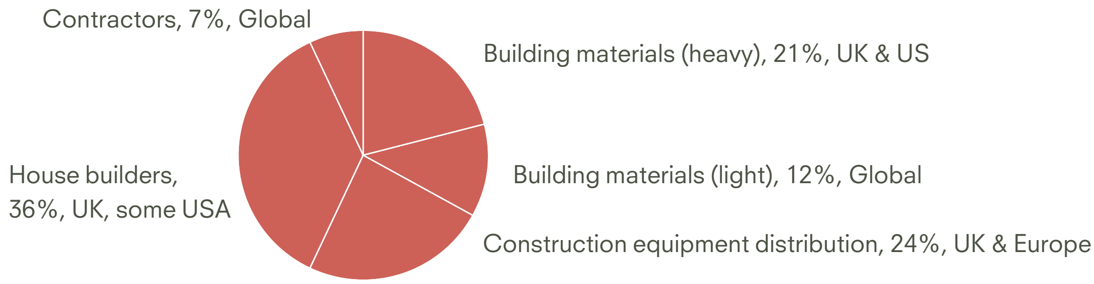
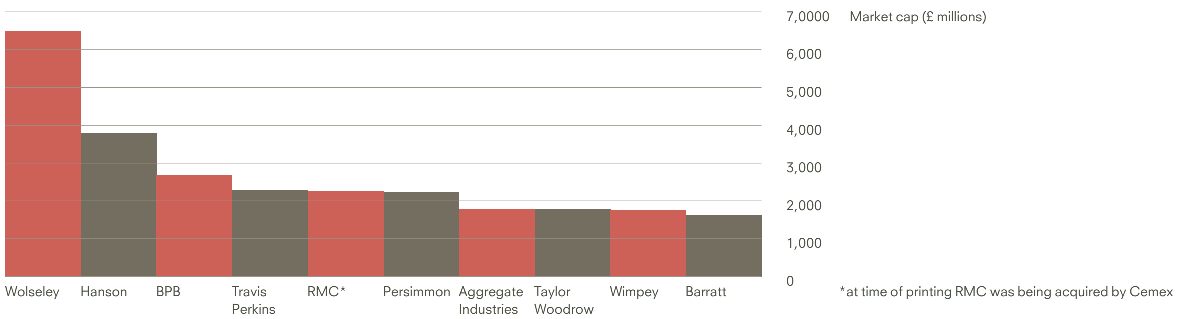
Features of the UK construction & building materials sector

Pie chart showing sub-sectors by percentage of UK industry and typical markets



- The direct footprint of this sector is significant; it is therefore being used by government to deliver social and environmental policies.
- The building materials sector is one of 5 targeted by the EU Emissions Trading Scheme for controls on carbon emissions.
- Other actors in the property development sector include real estate investors, property funds and pension funds, as well as building management companies.

Top 10 UK listed construction & building materials companies, February 2005



*at time of printing RMC was being acquired by Cemex

JUSTPENSIONS
SOCIALLY RESPONSIBLE INVESTMENT AND INTERNATIONAL DEVELOPMENT

License to operate in developing countries

Contractors' clients are often involved in physically intrusive infrastructure projects such as oil & gas installations, roads, utilities, dams etc. While a project client may be a multinational company or the government, it is often the contractor who is on the ground day to day, dealing with the local community and environment. Insufficient community consultation, land rights/resettlement packages, employment of foreign rather than local sub-contractors or the lack of perceived local benefit from a new installation or works are common causes of local dissent around large projects. Delays to site works due to protests at a contentious location can increase costs and reduce the profitability of low margin projects. A contractor's reputation with a client can be damaged if trouble flares up through mismanagement of local community or environmental issues.

Contractors skilled in community consultation and enhancing the social value of projects can reduce the risk of delays and also increase their appeal to clients involved in contentious projects. The involvement of international finance institutions in projects, requiring high social and environmental standards, could result in a competitive advantage to contractors able to demonstrate their ability to enhance social performance. Supply chains are a key mechanism through which investments in infrastructure can deliver economic benefits to local businesses. Indigenisation of the supply chain (for example by factoring the availability of local resources and products in design processes, and helping small and medium enterprises upgrade their procedures to meet quality assurance targets) can create work for local sub-contractors, secure cost efficiencies for the main contractor, enhance the brand and reputation of the client and contribute to poverty reduction within the region.

For further research on contractors' efforts to operate responsibly in developing countries visit www.engineersagainstpovery.org.uk.